

NO Protest Received

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224**

Date: **SEP 26 2000**

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

[REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

This is in reply to your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code.

We have reviewed the information you have submitted and have concluded that you do not qualify for recognition of exemption under section 501(c)(3) of the Code because you are not operating for exclusively charitable or educational purposes.

You were established to provide informational, educational, and community services and support research relating to the promotion of literacy as a social activity. Your primary activity is to publish in a serial format through newspapers never before published books. The authors who have participated in your program are current well known authors in the field of children's literature. You activities include working with the authors to adapt the stories for publication in a serial format. You consider your mission to be helping the public rediscover the joy and power of words.

Your property interest in the stories is limited to one time syndication rights for one year. Royalties are paid to the authors and illustrators and the authors and illustrators retain copyrights to the materials and can reproduce the books and sell them through the media after the serial has been run. The newspapers are charged a licensing fee based on the size of the newspaper's circulation with newspapers of smaller circulation paying less. You have provided a list of authors who have independently syndicated stories with newspapers. The fees these authors charged the newspapers appear comparable to those you charge. However, you distinguish these situations from your program in that the others utilize serialized stories as a marketing tool for previously published works, or syndicated short books. You also mention that you consider your fees to be far below market value. You give an example of the [REDACTED] a book from [REDACTED] for \$[REDACTED]

In the past, the royalties you have paid the authors were relatively small and did not compete with the revenue earned from traditional book sales. The fee and royalty structure has changed several times over the years. As reflected in your [REDACTED] letter you are planning to shift to a one-time payment of \$[REDACTED]. You indicate that the new royalty package is competitive with commercial publishing contractual arrangements. You have represented that authors have withdrawn from some your contractual arrangements because they can sell the book to trade book publishers for more money. You also represent that often trade book publishers do not want to follow up a successful newspaper serial with a book contract.

In addition to publishing the serials, you work with the newspaper and local schools or libraries to put together resource materials to enable the younger readership to get more out of the stories than they would get by merely reading the books. You also cooperate and collaborate with any curriculum developer and permit others to develop support materials. You do not charge for this assistance, however, title to such materials are permitted to be retained by the developer. We do not know the extent of this activity.

Section 501(c)(3) of the Code provides for the exemption from federal income tax for organizations organized exclusively for religious, charitable, educational, scientific and other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Federal Income Tax Regulations provides that an organization will be regarded as "operate exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in section 501(c)(3) unless it serves a public rather than a private interest. Thus, to met these requirements, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. It includes relief of the poor and distressed, the advancement of religion, and the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations states that the "educational," as used in section 501(c)(3) of the Code relates to (1) the instruction or training of the individual for the purpose of improving or developing his capabilities; or (2) the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the regulations states that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the activities which are in furtherance of one or more exempt purposes.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), Ct.D. 1650, C.B. 1945, 375, the Supreme Court of the United States held that the presence of a nonexempt purpose, if more than insubstantial, would destroy tax exempt status as a charitable organization.

In United States v. Wells Fargo Bank, 485 U.S. 351, 108 S. Ct. 1179, 99 L.Ed. 2d 368 (1988), the Supreme Court held that an organization must prove unambiguously that it qualifies for a tax exemption.

In Old Dominion Box Co. v. United States, 477 F.2d. 344 (4th Cir. 1973) cert. Denied 413 U.S. 910 (1973), the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974), holds that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In Incorporated Trustees of the Gospel Worker Society v. United States, 510 F. Supp. 374 (D.D.C. 1981) the Court determined that an organization that published religious literature of a non-denominational nature as its exclusive activity did not qualify for exemption under section 501(c)(3) of the Code. That organization paid its top personnel large salaries, accumulated substantial profits, and was in direct competition with a number of commercial publishers.

In Fides Publishers Association v United States, 263 F. Supp. 924 (N.D. Ind. 1967) the Court determined that a religious publishing house operated in a commercial manner which was independent of any religious body or organization and carried on no other activities, was not qualified for exemption under section 501(c)(3). The court acknowledged that its operations furthered the exempt purpose of educating individuals in a given area, but concluded that there was a substantial non-exempt purpose present -- the publication and sale of religious literature at a profit. The organization in question generated consistent operating profits and employed a commercial pricing pattern.

Rev. Rul. 66-104, 1966-1 C.B. 135 holds that a nonprofit organization which makes funds available to authors and editors for preparing teaching materials and writing textbooks, and under the terms of the contract with the publisher, receives royalties from sales of the published materials and then shares them with the editors and authors does not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 67-4, 1967-1 C.B. 121, provides that an organization engaged in publishing may qualify for exemption under section 501(c)(3) of the Code if it meets certain prescribed conditions. These conditions are that the content of the publication must be educational, the preparation of the materials follows methods generally accepted as "educational" in character, the distribution of the materials is necessary or valuable in achieving the organization's educational and scientific purposes, and the manner in which the distribution is accomplished is distinguishable from ordinary commercial publishing practices.

Rev. Rul. 77-4, 1977-1 C.B. 141, holds that a nonprofit organization, whose only activities are preparing and publishing a newspaper of local, national, and international news articles with an ethnic emphasis, soliciting advertising and selling subscriptions to that newspaper in a manner indistinguishable from ordinary commercial publishing practices, is not operated exclusively for charitable and educational purposes and does not qualify for exemption under section 501(c)(3) of the Code.

Whether an organization has satisfied the operational test is a question of fact. See Harding Hospital, Inc. v. United States, *supra*. As emphasized by the Supreme Court in United States v. Wells Fargo Bank, *supra*, qualification must be proven unambiguously.

The information you have submitted establishes that preparation of the serialized story for publication in newspapers you have entered into contracts with is your sole purpose. You also have some involvement in the preparation or distribution of resource materials however this is merely an extension of your other activities.

In determining whether an organization's engaged in publishing materials qualifies for exemption under section 501(c)(3) of the Code it is necessary to determine whether it is being operated in a commercial manner. See Rev. Rul. 66-104, *supra*. Rev. Rul. 67-4, *supra* and 77-4, *supra*. The information you have submitted establishes that your sole activity is to publish novelettes. These are published in a serialized format through local newspapers which contract with you to publish the story. The stories you publish compete with other books published for a similar audience. The financial information, regardless of your characterization, does not indicate that your fees are very distinguishable from those any book owner or publisher would charge for publication in a similar matter. In fact you have modified your fee structure to be able to become more competitive. We recognize that an author or for-profit publisher might wish to get their works presented to as large a portion of the general public as possible and could utilize serialization as a vehicle to advance their career. However, your program, even though a specific work may be made unprofitable by reason of having been published in a serial manner, is indistinguishable from a commercial publishing operation. See the holdings in Incorporated Trustees of the Gospel Worker Society v. United States, *supra* and Fides Publishers Association v United States, *supra*, wherein the Courts recognized that even commercial publishing of a religious nature absent any other factors is not considered an exempt charitable or educational activity.

Although section 1.501(c)(3)-(e)(1) of the regulations states that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities; the operation of such trade or business must be in furtherance of the organization's exempt purpose and the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. This is a factual determination and as noted above the information you have provided does not establish any basis for any conclusion other than the fact that you are operating a commercial publishing operation.

Furthermore, we recognize that your activities more than incidentally benefit the private business interests of the authors and illustrators you publish. You merely afford them another avenue through which to publish their works or to be able to showcase them. Whatever benefit the public receives through these authors and illustrators being permitted to showcase or advertise their works is incidental to the direct economic benefit received by the authors and illustrators. Operating to benefit private interests is not a qualifying charitable or educational activity. Similarly, because the authors and illustrators maintain copyrights to these works they have the benefit of any future earnings which can be made from the sale of these publications. This again operates for their own private benefit. See Old Dominion Box Co. v. United

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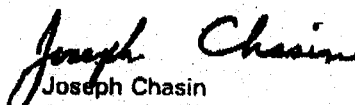
States, supra, which holds that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

Accordingly, we have concluded that you have not established that you qualify for recognition of exemption under section 501(c)(3) of the Code. Contributions to you are not deductible under section 170 and you are required to file Federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have the right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the U.S. Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

Sincerely yours,


Joseph Chasin
Acting Manager,
Exempt Organizations
Technical Group 2